## ACCOUNTING PRINCIPLES

### Meaning:

- Accounting Principles the rules adopted by accountants universally while recording accounting transactions.
- These rules etc. represent a consensus view of the profession for good accounting practices and procedures and are commonly referred to as Generally Accepted Accounting Principles (GAAP).
- These principles are classified into two categories:
    1. Accounting Concepts: These are the basic assumptions within which accounting operate. It enables the users of financial statements to understand them better.
    2. Accounting Conventions: These are the outcome of accounting principles being followed by the enterprises over a period of time.

### Features:

1. Accounting principles are Man-made. They are the best possible suggestions based on practical experiences.
2. Accounting Principles are flexible. These are not permanent and change with time.
3. Accounting principles are the bases and guidelines for accounting and are generally accepted. It depends on the following three criteria
    - Relevance
    - Objective
    - Feasible

### Necessity:

- Accounting information is better understood if it prepared following Accounting Principles.
- If accounting records and financial statements are prepared according to Accounting Principles' standard forms then it shall be useful for users.

## FUNDAMENTAL ACCOUNTING ASSUMPTION OR CONCEPTS

These are assumptions which are presumed to have been followed in preparing the annual accounts. The entities which are not followed these assumptions are required to disclose with reasons.

1. **Going Concern Assumption:**
    - It is assumed that business shall continue for a foreseeable period and there is no intention to close the business.
    - Since this concept believes in the continuity of the business over an indefinite period, it is also known as continuity concept.
    - It is because of the going concern concept that distinction between
        a) fixed assets and current assets
        b) short-term and long-term liabilities and
        c) Capital and revenue expenditure is made.

2. **Consistency Assumption:**
    - The aim of consistency principle is to preserve the comparability of financial statements.
    - The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year.
    - For example, depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

### 3. Accrual Assumption:

- The essence of accrual concept is that revenue is recognised when it is occurred or realised i.e. when sale is complete or services are given and it is immaterial whether cash is received or not.
- Similarly, according to this concept, expenses are recognised in the accounting period in which they help in earning the revenues whether cash is paid or not.
- Thus, to ascertain correct profit or loss for an accounting period we must take into account all expenses and incomes relating to the accounting period whether actual cash has been paid or received or not.
- It is because of this concept that outstanding expenses and accrued incomes are taken into accounts.

## ACCOUNTING PRINCIPLES

### 1. Accounting Entity or Business Entity Principle:

- According to this principle, business is treated as a unit or entity apart from its owners, creditors and others.
- All the business transactions are recorded in the books of accounts from the view point of the business.
- This principle applies to every form of enterprise including proprietorship firms.

### 2. Money Measurement Principle:

- In accounting, only those business transactions and events which are of financial nature are recorded.
- In other words, money is the common denominator in recording and reporting all transactions.
- Example – an enterprise has 10 tonnes of raw material, 10 trucks and 5,000 sq. Yards land. These assets can't be recorded in Financial Statement unless their monetary value is ascertained.

### 3. Accounting Period Principle:

- Accounting period refers to the time period at the end of which the financial statements of a business enterprise are prepared so as to know the amount of profit earned or loss incurred by it during that period of time as well as the position of its assets and liabilities at the end of that period of time.
- The life of the enterprise is broken into smaller periods (usually one year) which is termed as 'Accounting Period'.

### 4. Full Discloser Principle:

- According to this convention, all accounting statements should be honestly prepared and to that end full disclosure of all significant information should be made.
- All information which is of material interest to proprietors, creditors and investors should be disclosed in accounting statements.
- Apart from legal requirements, good accounting practice requires all material and significant information to be disclosed.

5. **Materiality Principle:**
    - The materiality principle requires all relatively relevant information should be disclosed in the financial statements.
    - Unimportant and immaterial information are either left out or merged with other items.
    - Whether an item is material or not will depend on its nature and/or amount.

6. **Prudence or Conservatism Principle:**
    - Prudence principle takes into consideration all prospective losses but leaves all prospective profits.
    - The essence of this principle is "anticipate no profit and provide for all possible losses".
    - For example, while valuing stock in trade, market price or cost price whichever is less is considered.

7. **Cost Concept or Historical Cost Principle:**
    - According to this principle, an asset is recorded in the books of accounts at the price paid to acquire it and the cost is the basis for all subsequent accounting of the asset.
    - Market value of an asset may change with the passage of time but for accounting purposes it continues to be shown in the books of accounts at its book value.

8. **Matching Concept or Matching Principle:**
    - This concept requires that the expenses of a period must be matched with the revenues of that period for the ascertainment of the profit earned or loss suffered by the enterprise during that period.
    - In other words, matching the revenues earned during an accounting period with the cost associated with the period to ascertain the result of the business concern is called the matching concept.
    - It is the basis for finding accurate profit for a period which can be safely distributed to the owners.

9. **Dual Aspect or Duality Principle:**
    - Dual aspect principle is the basis for Double Entry System of book-keeping.
    - All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit.
    - For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).
    - Capital (Equities) = Cash (Assets)

      Or

      Owner's equity + Claims of outsiders = Assets

10. **Revenue Recognition Concept:**
    - This convention helps in ascertaining the amount and time of recognising revenues from business activities.
    - Revenue is considered to have been realised when a transaction has been entered into and the obligation to receive the amount has been established.
    - In other words, Revenue is said to have been earned in the period in which sales have taken place or services have been rendered to the satisfaction of the customers and the revenue has been received or has become receivable.

11. **Verifiable Objective Concept:**
    - This concept states that accounting should be free from personal bias.
    - Measurements that are based on verifiable evidences are regarded as objectives.
    - It can be said that all accounting transactions should be evidenced and supported by business documents.

## ACCOUNTING STANDARDS

To promote world-wide uniformity in published accounts, the **International Accounting Standards Committee** (IASC) has been set up. The purpose of this committee is to formulate and publish in public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. IASC exist to reduce the differences between different countries' accounting practices. In our country, the **Institute of Chartered Accountants of India** has constituted Accounting Standard Board (ASB). The ASB has been empowered to formulate and issue accounting standards that should be followed by all business concerns in India.

**Meaning:**

- The Accounting Standards are a set of guidelines issued by the ICAI that are followed for preparation and presentation of Financial Statements.
- These are accounting rules and procedures relating to measurement, recognition, treatment, presentation and disclosure of accounting transactions in the financial statements.

**Nature:**

- Accounting Standards are the guidelines.
- Objective is to bring uniformity in accounting practices and to ensure transparency, consistency, and comparability.
- Business environment and law of the country are considered while making Accounting Standards.
- Accounting Standards are mandatory in nature.
- Accounting Standards have also been made flexible in the sense that where alternative accounting practices are acceptable, an enterprise is free to adopt any of the practices with suitable disclosure.

**Objectives:**

- Minimise the diverse accounting practices.
- Promote better understanding of financial statements.
- Understand significant Accounting Policies adopted and applied.
- Ensure meaningful comparison of financial statements of two or more entities.
- Enhancing reliability of financial Statements.

**Utility:**

- Provides the norms on the basis of which financial statements should be prepared.
- Ensure uniformity in the preparation & presentation of financial statements.
- Create a sense of confidence among the users of accounting information. Accounting information created by applying Accounting Standards is considered reliable by users of such information.
- Help auditors in auditing the accounts.
- Helps accountants to follow uniform practices and policies.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

### Need:

In this age of globalisation and technology, enterprises are carrying on business worldwide. Therefore there is a need of single set of accounting standards that can unify the accounting practices worldwide.

Thus, International Accounting Standard (IAS) were developed, which are being superseded by International Financial Reporting Standards (IFRS).

The International Accounting Standards Committee (IASC) established in 1973 was replaced by International Accounting Standard Board (IASB) in the year 2001 which now issue IFRS.

### Objectives of IASB

- To develop, in the public interest, a single set of high quality, understandable, and enforceable global accounting standards.
- To promote the use of developed IFRS.
- To bring about convergence of national accounting standards and IFRS to high quality solutions.

### Meaning of IFRS

- IFRS are a set of accounting standards developed by the International Accounting Standard Board.
- IFRS referred to as principles-based accounting standards because these are based on sound and clearly stated principles.